FESE
FEDERATION OF EUROPEAN SECURITIES EXCHANGES

Response
Commission Consultation Paper a Revision of the Market Abuse Directive (MAD)

Introduction

The **Federation of European Securities Exchanges** (FESE) represents 45 exchanges in equities, bonds, derivatives and commodities through 20 full members from 29 countries, as well as 7 Corresponding Members from European emerging markets. FESE is a keen defender of the Internal Market and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE represents public organised markets operated as Regulated Markets (RMs). Regulated Markets provide both institutional and retail investors with transparent and neutral price-formation. Securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws.

RMs have a unique perspective on preventing market abuse, because of the following factors:

- RMs provide an orderly, efficient and transparent market for the benefit of all investors.
- RMS provide neutral venues; we do not have a commercial interest in the product traded (i.e. we do not benefit from the proceeds of moving a long/short position) which contrasts with the case of SIs, OTC and to some degree certain MTFs, if the owners/operators hold underlying positions – in which case they would have a conflict of interest which is not present in RMs.
- Moreover, RMs have long assumed a central role in the oversight and supervision of markets, investing for decades in the systems, human resources and expertise required to detect and prevent market abuse of all kinds.
- Having said this, MiFID has created greater competition in trading and other services, which have had an impact on how market abuse is monitored. Many of the new venues, set up as MTFs, have also invested in market integrity, and are bound by the same legal obligations as RMs to monitor their markets. Brokers on the other hand are also bound to take certain steps in support of market surveillance (i.e. the obligations imposed by MAD such as suspicious transaction reporting).
- Notwithstanding the intention of EU policymakers to set up comprehensive market abuse rules for all trading, wherever it happens, MiFID has generated a number of distinct difficulties for market integrity:
    - MiFID has resulted in the fragmentation which creates gaps in exchange surveillance data and additional challenges for the ability of individual venue operators to effectively safeguard market integrity. As a matter of practical fact, surveillance is about detecting irregularities with respect to time. MiFID may have intensified workload for some markets and created missing gateways to exchange data which limit efficient surveillance and proportionately increase surveillance costs.
    - In certain cases, supervisors have not expected the new venues established by MiFID to devote the same kind of resources to market integrity, especially when the venues are smaller. Given that market abuse can happen irrespective of the size of market, the absence of equal enforcement of market abuse creates a loophole for possible abusers.
    - Diverse security mechanisms to provide orderly trading (such as e.g. halts on trading) at the RMs which are the primary markets of a security are not necessarily replicated in other venues, which means that the end investor may be negatively impacted if prices are incorrect or artificial.

- With these difficulties in mind, we believe that the revision of MAD can be very constructive in bringing the MAD rules in line with current trading environment. In particular, we recommend the following improvements:
    - All enforcement type (and any remaining minor legal) differences between the surveillance done by RMs and MTFs trading instruments admitted to trading on a RM should be eliminated. In most cases, this is a matter of better enforcement only.
    - There needs to be a level playing field and cooperation across all execution venues with potentially Level 3 definitions covering issues such as alerts, data standards, and information sharing.
    - There should be independent scrutiny of broker/MTF matching algorithms/engines in order to avoid/mitigate so mentioned potential conflict of interest provided that users cannot effectively scrutinise these.
    - Overall, the new MAD regime should ensure an effective oversight of all activity in the same product (a stock could be traded simultaneously on the home RM and a number of MTFs and OTC spaces). Pan-European surveillance can only happen with greater cooperation among the venues and between the venues and the supervisors.
- Finally, with regard to proposed extension of the MAD regime to financial instruments and venues that are currently not covered, FESE members strongly believe that the requirements of MAD related to disclosure of inside information, directors' dealings and insider lists etc. should not apply to financial instruments when they are admitted to trading on a MTF.

A. EXTENSION OF THE SCOPE OF THE DIRECTIVE

(1) Should the definition of inside information for commodity derivatives be expanded in order to be aligned with the general definition of inside information and thus better protect investors?

FESE members agree that the protection of investors should be at the forefront of the MAD review, and support the proposed definition of inside information in the draft legislation.

Dividend policy and market abuse

We would like to refer to a particular situation in derivatives markets that can constitute inside information: dividends payments, dates and general policy. This was reflected in CESR's second set of guidance and information on the common operation of the Market Abuse Directive http://www.cesr-eu.org/popup2.php?id=4683. This guidance was intended for the CESR members to apply this in their day-to-day regulatory practices on a voluntary basis. In addition to the CESR guidelines, the need for a timely, exhaustive and harmonised disclosure on dividends by listed companies is also one of the main purposes of current industry initiatives. This was reflected in the Market Standards for Corporate Actions finalised in May 2009 by the Corporate Actions Joint Working Group[1].

Despite these efforts and although CESR has signalled the potential for dividends policy to constitute inside information, current market practice is still of concern and could have a negative effect on market participants, which should not be unduly impacted by unforeseen changes in dividend policy. To address this issue, we request European Regulators to provide solutions towards the way dividend information is given by the issuers to the markets. Many companies have not adopted a clear dividend policy that is in

[1] The Group's objective has been to develop a comprehensive set of market standards for the operational processing of all categories of corporate actions, including distributions such as dividends. This work is aimed at solving the current situation characterized by the variety of rules, information requirements and deadlines for corporate actions. Standardizing these processes across all European markets, and possibly beyond, aims at achieving a significant reduction of respective costs and operational risks. In particular on dividends payment, the document makes clear the proposal sequences of dates for cash distributions, specifying the minimum business days for the announcements of the dividend payment by the issuer and the ex date. The document produced by the Working Group is available at: http://www.europeanissuers.eu/_lib/newsflash/CAJWG%20Standards%20Version%20for%20endorsement%208May09.doc.pdf

line with international corporate governance standards. It appears that some issuers underestimate the impact of changes in their dividend policy on positions (in cash and derivatives) held by the investors in their companies.

We would advocate for the European regulators (the future ESMA) to recommend or require issuers, whose shares and derivatives are listed in the regulated markets or constituents of main indices, to follow some basic rules regarding disclosure of dividend information (see Appendix). This could be done in the context of the review of the Market Abuse Directive.

(2) Should MAD be extended to cover attempts to manipulate the market? If so why? Is the definition proposed in this consultation document based on efficient criteria to cover all cases of possible abuses that today are not covered by MAD?

Yes, we believe that MAD should be extended to cover attempts at market manipulation. Whether the attempt was successful or not in manipulating markets is not central to market integrity; all attempts at market manipulation affect the quality of the market and ultimately investors' confidence.

As referred to in the Public Consultation, we would very much appreciate detailed practical guidance by ESMA on the operational aspects of this regime.

(3) Should the prohibition of market manipulation be expanded to cover manipulative actions committed through derivatives?

FESE members agree with the need to extend the prohibition of market manipulation as well as the prohibition of insider dealing for derivatives. In the latter case and as mentioned above, we do not think that prohibition, as depicted, is suitable for all commodity derivatives. In particular we believe that it would make sense to extend these prohibitions to standardised and CCP clearable derivatives, but not to customised OTC ones.

Further to this, from a pure surveillance point of view, excluding customised OTC derivatives might enable a loophole, as the interdependence still exists and can be abused to influence the underlying or an evaluation position, an example being the much cited Porsche/Volkswagen case; Flex contracts could have been used to engage in the same nature of transactions. For the benefit of an orderly market the rationale should be to at least prohibit market manipulation in such transactions as well.

(4) To what extent should MAD apply to financial instruments admitted to trading on MTFs?

FESE members support the application of the secondary market provisions of the market abuse regime, regarding insider dealing and market manipulation, to financial instruments admitted to trading on MTFs as this would enhance the integrity of the MTF regime across Europe. However, we believe that the primary market aspects (Art 6(1) to (4) of MAD which requires *inter alia* disclosure of inside info, maintenance of insider lists and disclosure of transactions) should not be included.

Many of the MTFs operated by stock exchanges in Europe are junior/specialist markets and are designed specifically to facilitate the capital raising activities of small and medium-sized enterprises and their regulatory regimes for issuers are purposely less onerous than the regimes that apply to companies on 'regulated markets'. In the case of MTFs operated by FESE members, the regulatory regimes that apply to the issuers on these markets have been specifically designed to meet their needs whilst providing appropriate protection for investors. MTF rule books do require the disclosure of inside information from issuers listed on MTFs. We believe that is not desirable or necessary to impose the primary market aspects of the directive on these issuers as we believe this would lead to a significant increase in legal and other costs for these issuers with no additional benefit for the market recipients of the relevant announcements. This could have serious repercussions for small and medium-sized enterprises which may already be experiencing financial difficulties, given the current financial and economic climate.

Furthermore, the existing rules which apply to companies quoted on these MTFs already cover the substance of the primary market requirements of the MAD. We would argue that if the requirements for issuers on MTFs are aligned with those that apply to issuers on 'regulated markets', then the attractiveness of MTFs to smaller growth companies could be significantly diminished.

Moreover, there will be a greater need for these MTFs in the aftermath of the financial and economic crisis, as a result of which many medium-sized companies might reasonably have even less access to credit and other sorts of financing. In any event, accessing public capital markets has unique advantages for the SMEs (which also correspond to important advantages for the investors in these companies.

Some SMEs already have difficulty shouldering the burden of admission on an MTF; if this act triggered even greater burdens, such SMEs would lose access to markets altogether.

In conclusion, the requirements of MAD (such as disclosure of inside information, directors' dealings and insider lists etc.) should not apply to financial instruments when they are admitted to trading on a MTF.

Finally, it should be taken into account that some Member States have already applied MAD to the MTFs in their jurisdiction, including those requirements which we consider to be cumbersome for SMEs. Assuming that the scope and application of MAD are amended in the way we recommend above (including primary market MTFs but not applying certain requirements to these markets so as to accommodate the needs of their issuers), the application of the revised MAD has to be consistent in all jurisdictions, so that all primary market MTFs should be able to benefit from the same exemptions.

(5) In particular should the obligation to disclose inside information not apply to issuers who only have instruments admitted to trading on an MTF? If so why?

We agree that this should not apply as it creates too much burden, especially for SMEs.

(6) Is there a need for an adapted regime for SMEs admitted to trading on regulated markets and/or MTFs? To what extent should the adapted regime apply to SMEs or to "companies with reduced market capitalisation" as defined in Prospectus Directive? To what extent can the criteria to be fulfilled by SMEs as proposed for such an adapted regime be further specified through delegated acts?

There is no need for an adapted regime neither for SMEs admitted to trading on MTFs nor for SMEs admitted to regulated markets. The current market structure allows SMEs to choose the type of transparency they are willing to show.

As stated before under point (4), the **issuer related parts of the MAD regime** should not be applicable to MTFs in the first place and thus not even an adapted regime for SMEs admitted to MTFs (junior markets).

We do also not support an adapted regime of reduced disclosure standards for SMEs admitted to regulated markets as certain disclosure standards are expected from investors. If those SMEs would be released from the disclosure of inside information, directors' dealings etc., it would be difficult for investors to distinguish between them and the higher capitalized companies[2] (keep the changing market values over time in mind).

From our perspective the current market structure offers SMEs good access facilities to the capital markets.

[2] We do not support the definition of SMILEs as proposed by the report of Mr. Demarigny.

B. ENFORCEMENT POWERS AND SANCTIONS

(7) How can the powers of competent authorities to investigate market abuse be enhanced? Do you consider that the scope of suspicious transactions reports should be extended to suspicious orders and suspicious OTC transactions? Why?

FESE members agree that the scope of suspicious transactions reports should be extended to suspicious orders and suspicious OTC transactions.

We also wish to underline the importance of ensuring strict proper enforcement of STR obligations and to allocate sufficient resources to investigate the suspicious transactions that are reported to authorities. We note that already today article 6.9 of MAD require reports on suspicious transactions in financial instruments.

(8) How can sanctions be made more deterrent? To what extent need the sanction regimes be harmonised at the EU level in order to prevent market abuse? Do you agree with the suggestions made on the scope of appropriate administrative measures and sanctions, on the amounts of fines and on the disclosure of measures and sanctions? Why?

We agree that sanctions should be more consistent across Europe.

Otherwise there would somehow be an incentive to regulatory arbitrage, i.e. different sanctioning regimes for market abuse for some Member States than others, which would not favour the safety of the system as a whole.

(9) Do you agree with the narrowing of the reasons why a competent authority may refuse to cooperate with another one as described above? Why? What coordination role should ESMA play in the relations among EU competent authorities for enforcement purposes? Should ESMA be informed of every case of cooperation between competent authorities? Should ESMA act as a binding mediator when competent authorities disagree on the scope of information that the requested authority must communicate to the requesting authority?

Yes we agree, as it would reinforce consistency. Though it is an aim in itself, we would like to note that further and tighter cooperation between the relevant competent authorities has become even more relevant provided the current fragmented EU market. Cross-border activity and the current multiple trading venue framework as depicted in MiFID, together with the trading volumes made in the equity OTC space (which, according to CESR data on 2009 trading volumes, **comprises 38% of all trading**), lead us to support the proposed enhancement and strengthening of cooperation.

(10) How can the system of cooperation among national and third country competent authorities be enhanced? What should the role of ESMA be?

An information-sharing regime with respect to market operators could be implemented as is the case for example with the Intermarket Surveillance Group.

Moreover, we suggest that ESMA define minimum cooperation guidelines for national and 3rd country cooperation.

C. SINGLE RULE BOOK

(11) Do you consider that a competent authority should be granted the power to decide the delay of disclosure of inside information in the case where an issuer needs an emergency lending assistance under the conditions described above? Why?

Yes, we do, because of the intricate involvement of the competent authority in this case.

However, some practical questions will arise:

- What happens in cases where the emergency aid is being discussed but not yet decided?
- What happens in cases where the emergency aid is being decided by a part of the government other than the competent authority?

Each Member State needs to take a clear and consistent approach to these cases. We would advocate for a consistent and homogenous approach across the EU, reducing to the maximum possible extent any divergences between member states.

In addition, we strongly support the general principle of greater clarity in the communication on these delays with the authorities. In the past, there have been cases where some authorities asked to be informed of the delay, and then others who did not require to be informed, but if they were informed, then they were statutorily required to make this fact public, thereby obliterating the whole benefit of a delay. Therefore we fully support the proposal that the delay needs to be communicated to the authority only after it has been exercised. The wording of the amendment should ensure that all MSs apply it in the same way in terms of what the obligation is and when it needs to be fulfilled.

(12) Should there be greater coordination between regulators on accepted market practices?

Yes, we definitely agree with this. The absence of a meaningful AMP regime was one of the main obstacles for the consistent application of MAD. To address this problem, we would support:

1) introducing the concept of a European AMP, which will be valid in all MSs and
2) as an additional level, including a number of country-specific AMPs.

(13) Do you consider that it is necessary to modify the threshold for the notification to regulators of transactions by managers of issuers? Do you consider that the threshold of Euro 20,000 is appropriate? If so why?

No, we do not believe that the threshold should be increased. We suggest keeping it at the current level as the intention of MAD is to show more transparency.

(14) Do you consider that there are other areas where it is necessary to progress towards a single rulebook? Which ones?

Much progress towards a single rule book in fact lies at the implementation and application level. It is necessary to implement the proposals in the de Larosière report in order for CESR/ESMA to be given a stronger role as regards supporting the uniform implementation and application of the MAD.

An area where further harmonization may be needed is the interpretation and practical application of the rules regarding reporting of managers' transactions.

We also believe that the national rules and practices regarding delayed disclosure can be further harmonized. This concerns the interpretation of when delayed disclosure is allowed and also if anyone, and who, needs to be informed about a delay. For instance, there have been instances in the past when an issuer was forced by some supervisors to inform the supervisor of a pending delay, whereas other

supervisors of the same (multi-jurisdictional) issuer did not want to be informed of any delay, but if they were informed voluntarily, then they wanted the information to be made public – thereby negating the usefulness of the delay mechanism. This example shows that all the procedures have to be based on a single set of principles.

(15) Do you consider that it is necessary to clarify the obligations of market operators to better prevent and detect market abuse? Why? Is the suggested approach sufficient?

It would not be practical for Members States to introduce additional specific obligations on regulated market operators in relation to the necessary technical systems, tools and procedures and appropriate human resources required for detecting market abuse. Regulated market operators already have sufficient obligations and requirements in relation to operating their markets as detailed in MiFID which include notifying the competent authority regarding suspected market abuse and we do not believe that further specific obligations should be imposed. It is unclear to us whether the Commission was suggesting that operators of MTFs are covered by this question or not. The approach in various jurisdictions seems to be that the relevant competent authorities do not seek to impose the same market monitoring requirements on regulated market operators and MTFs. This is an enforcement problem that should be addressed.

In fact, we think that the term 'market operator' in this context is inappropriate and inconsistent with MiFID, which was adopted several years after MAD. Whenever describing the obligations of the operators of trading venues in terms of market abuse, MAD should refer to either 'operators of trading venues' or 'operators of RMs or MTFs' to ensure that it includes both 'market operators' in the sense of MiFID (who can operate RMs or MTFs) and investment firms (who can operate either MTFs or Systematic Internalisation platforms) under MiFID). The current wording of MAD is unfair because it seems to put all the responsibility of surveillance on the 'market operators', thus leaving MTFs run by investment firms outside the scope.

The practical experience with the implementation of MiFID and MAD together also reinforces the problems created by this ambiguity. As a matter of fact, many MTF run by investment firms have not been asked to invest similar resources to surveillance as the RMs or MTFs run by market operators.

Thirdly, the problems encountered in pan-European surveillance have to be acknowledged and addressed by both MiFID and MAD revisions. No single venue has enough information to do pan-European real-time surveillance, but neither should that be expected of any single venue. We recommend greater cooperation among venues and between venues and supervisors on this point. Effective gateways for exchanging/disclosing information between market operators (RMs/MTFs) should be established.

Appendix - rules regarding disclosure of dividend information

1. Every issuer should make a declaration of a pattern/schedule of ex-dividend dates to stick to it every year. The pattern/schedule should include month and date of payment for all the ordinary payments the company may make. The date does not need to be exact, it will be sufficient that the issuer commit that the payment will be always made the day after the expiration of the derivative contracts (usually on the third Friday of any particular month).

2. Amounts of the dividends should be confirmed timely, whether as a proposal to the Annual General Meeting or as a firm decision.

3. Issuers should avoid unjustified changes to the declared dates, and, if a change is unavoidable, explain the reason for it.

4. Issuers should avoid unjustified delays in releasing any information regarding the payment of dividends.

5. Any major change in the date pattern, like changing from half-yearly to quarterly payments, should be announced a long time before its implementation.

6. Every payment should be identified by the issuer as ordinary or as special.